Developments in Financial Reporting and Regulations

June 2022

COVID-19 potential accounting impacts

Directors and management are required to consider the risk of COVID-19 within the Company, and the direct and indirect financial impacts on the business and the annual financial report.

Accounting implications

- Asset **impairment** (including goodwill) or changes in assumptions for impairment testing
- Change in **fair value** of assets (AASB 13) or net realisable value of inventory (AASB 102)
- Increased costs/ or reduced demand requiring **provisions** for onerous contracts, provisions for employee layoffs etc. (AASB 137)
- **Revenue recognition** effect relating to contract modifications, ability to meet performance obligations, collectability and other
- Changes in **expected credit losses** for loans and other financial assets (AASB 9)
- Material uncertainties that cast significant doubt on the ability to continue as a **going concern** such as extent of impact on future costs and revenues (AASB 101 and AASB 110) and unknown duration of impact

Disclosures

- Where there is a financial impact, this may include **valuation and estimation assumptions** or assumptions used in sensitivity analyses
- Entities should also disclose information about assumptions regarding the future, and other major sources of **estimation uncertainty**
- Where there is no financial impact in the current reporting period, entities should make disclosure of their key assumptions as to why it has not had an impact
- **Subsequent events**

Accounting standard changes

Investments in Information Systems

IFRIC (the International Financial Reporting Interpretations Committee, a committee of the International Accounting Standards Board) received a request addressing how a customer should account for costs of configuring or customising a supplier’s application in a Cloud Computing or Software as a Service (SaaS) arrangement.

It was identified that significant diversity in practice had developed and it was determined appropriate for an Agenda Decision to be drafted and released. It was determined by IFRIC that sufficient guidance exists within the relevant accounting standards and that no amendments to accounting standards were required. The rationale for arriving at this conclusion – which forms part of the interpretation of IFRS – forms the Agenda Decision.

What does the Agenda Decision require?

The Agenda Decision requires that management capitalise those elements of expenditure that meet the definition of an “Intangible Asset” as defined by AASB 138 Intangible Assets and recognise any additional amounts as an expense as the entity benefits from the expenditure – either by applying AASB 138 or applying another accounting standard.

The Agenda Decision then clarified:

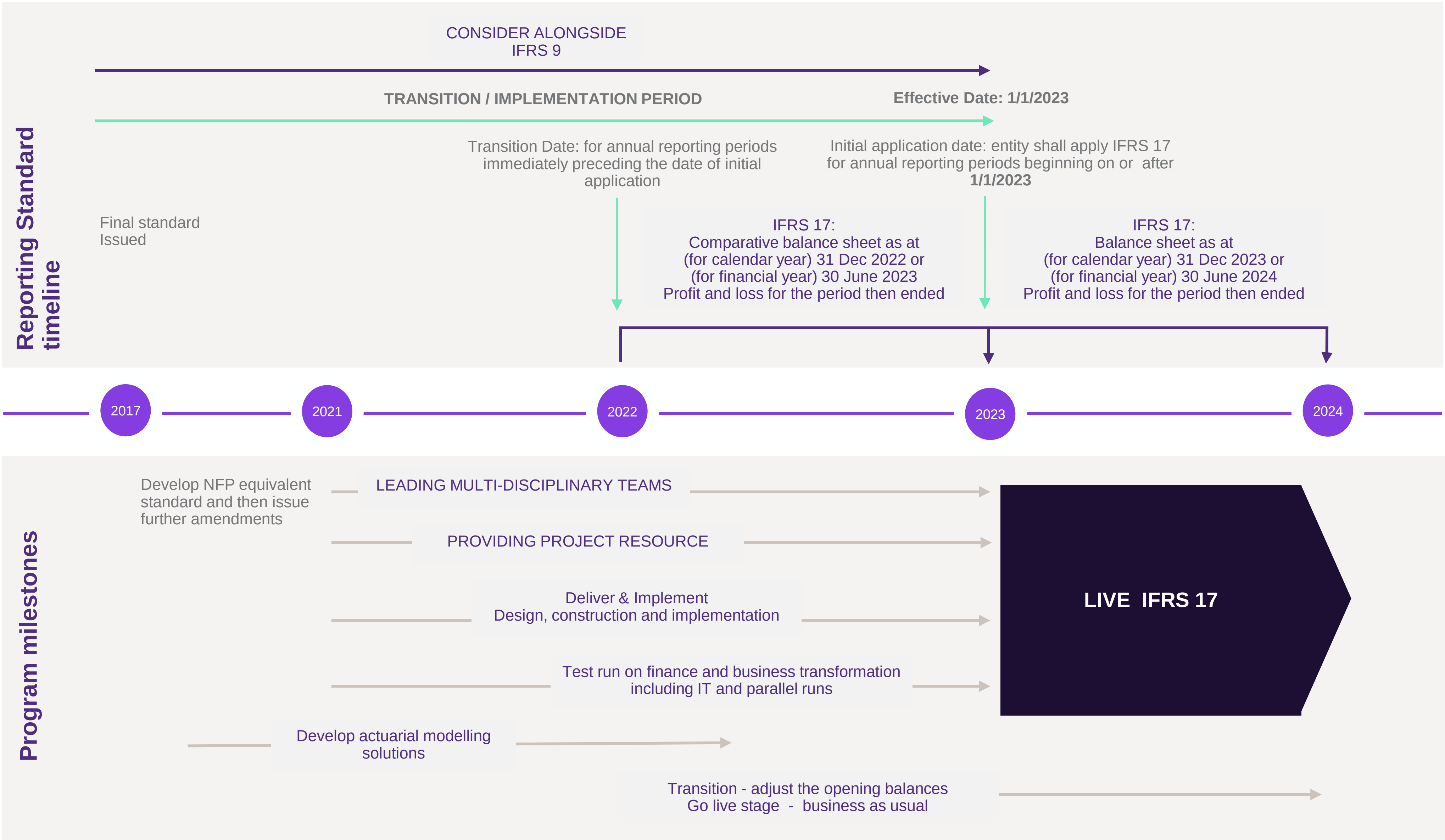
- The nature of expenditure that met the definition of an Intangible Asset;
- Methods of differentiating between Intangible Assets and expenses; and
- The pattern in which the entity benefits from expenditure that does not qualify as an Intangible Asset.

More information can be found here.

30 June 2022 implications:

With the multitude of technology advancements and shifts that are reshaping products and services, significant investment is expected to continue. It is important to assess the nature of the contractual arrangements and in particular the costs of configuring or customising a supplier’s application in a Cloud Computing or Software as a Service (SaaS) arrangement to ensure this is compliant with Accounting Standards and the IFRIC Agenda Decision.

IFRS 17: The only certainty is change



IFRS 17: The implementation plan. **Read more**.

IFRS 17: Disclosure requirements

ASIC Media Release - 20-286MR - Insurers urged to respond to new accounting standard

In its media release on 17 November 2020, ASIC called on insurers to respond to the new accounting standard and asked them to make disclosures about AASB 17 *Insurance Contracts* in their forthcoming financial reports.

In accordance with AASB 108, when an entity has not applied a new Australian Accounting Standard that has been issued but not yet effective the entity must disclose this fact and include within its financial statements the "known or reasonably estimable information relevant to assessing the possible impact that application of the new Australian Accounting Standard will have on the entity's financial statements in the period of initial application."

For a significant new standard such as AASB 17, insurers are expected to present specific disclosures about their transition approach and ultimately, once known, a quantification of the estimated impact of this standard.

With the application date now deferred to 1 January 2023, ASIC has set the expectation that quantitative information will be available for periods ending on or after 30 June 2021. However, if the impact of the new standard can't be quantified, the entity is required to included other qualitative disclosures such as how the new standard will generally affect the industry, and the status of the entity's implementation.

To this end, the ASIC release highlighted a number of areas that should be considered as part of the implementation plan including:

- identifying changes to accounting treatments,
- required system changes,
- business impacts,
- impacts on compliance with financial requirements,
- disclosures required in financial reports prior to the effective dates of the standards,
- possible continuous disclosure obligations, and
- the impact on any fundraising or other transaction documents.

Specifically 20-286MR outlined the need to consider as part of any implementation plan the ability to determining how the new standard will impact on future financial reports in areas such as:

- the contracts affected,
- contract grouping,
- contract boundary,
- acquisition costs,
- the measurement models used,
- risk adjustments, and
- any components of the contracts that require separation.

Click **here** to read the Media Release along with further guidance issued by the TRG:

Further assistance can also be obtained from the papers published by the AASB PHI Focus Group, (which Grant Thornton is a member of). The purpose and function of this group is to review the areas of the standard where application is not clear for health insurers and report to the AASB Transition Resource Group (TRG). The TRG is the AASB committee which oversees the process of integrating feedback on the standard (before it is completed) and interpretation of the standard for the AASB. Please click **here** to review the minutes.

30 June 2022 implications:

With the effective date fast approaching, it is reasonable to assume ASIC will require more detailed disclosures in the 30 June 2022 financial statements around the company's transition approach, including the implementation plan, its status and the quantification of the estimated impact of this standard.

IFRS 17: IASB Updates

IASB provides transition option to insurers applying IFRS 17 ©

On 9 December 2021 the International Accounting Standards Board (IASB) issued a narrow-scope amendment to the transition requirements in IFRS 17 *Insurance Contracts*, providing insurers with an option aimed at improving the usefulness of information to investors on initial application of the new Standard.

The amendment relates to insurers' transition to the new Standard only— it does not affect any other requirements in IFRS 17.

IFRS 17 and IFRS 9 *Financial Instruments* have different transition requirements. For some insurers, these differences can cause temporary accounting mismatches between financial assets and insurance contract liabilities in the comparative information they present in their financial statements when applying IFRS 17 and IFRS 9 for the first time.

The amendment will help insurers to avoid these temporary accounting mismatches and, therefore, will improve the usefulness of comparative information for investors. It does this by providing insurers with an option for the presentation of comparative information about financial assets.

IFRS 17, including this amendment, is effective for annual reporting periods starting on or after 1 January 2023.

For more information please refer to https://www.ifrs.org/ for direct access please see link *Initial Application of IFRS 17 and IFRS 9—Comparative Information* (NB:IFRS Digital subscription is required).

Expected implications:

We do not expect this transition option to have a significant impact on our Private Health Insurer clients as the majority of private health funds have already adopted IFRS 9 in prior periods. As such we expect most Private Health Insurers to consider the transition options under IFRS 17: Para C29 relating to the "Redesignation of financial assets" to be of more assistance.

Environmental, Social and Governance (ESG) Strategy and Reporting

The journey to a more sustainable future for businesses isn't just about reporting.

ESG Strategy

ESG Strategy covers an organisation's policies and activities as they relate to ;

- Environmental impacts – the organisation's impact on the natural environment.
- Social impacts – how the organisation manages relationships with employees, suppliers, customers, and the communities in which it operates.

ESG Reporting

- ESG disclosures help stakeholders to evaluate an organisation's performance in meeting its ESG strategy, as well how well the organisation has identified, managed and measured ESG risks and opportunities.
- Reporting helps to establish and maintain trust between an organisation and its stakeholders.

Challenges

- While it is fundamental to the sustainability journey, it's also important for businesses to create a long-term vision, goal and values structure that will help see them through this transition.
- In a key challenge for many lies in understanding what to prioritise for maximum impact in the move to more sustainable business practices, particularly when limited resources are stretched thin due to the pandemic.

The top three obstacles indicated in the latest IBR data are:

- Busy dealing with issues linked to the pandemic (31%)
- Lack of clarity around new regulations/requirements (31%)
- Concerns about the costs related to taking action (30%)

Specialist advice can be invaluable when navigating the myriad reporting frameworks for sustainability. While mid-market businesses' natural ability to adapt will help, there is a clear role for government, regulators, and standard setters to provide support and establish clear pathways to best practice reporting on sustainability matters.

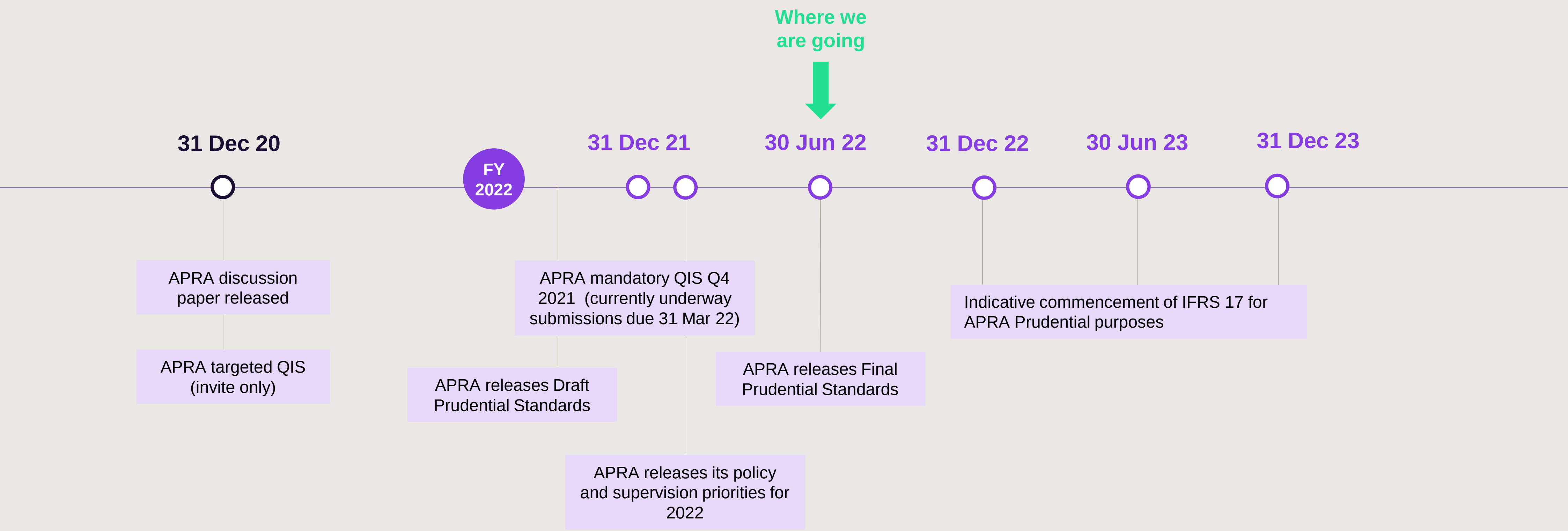
Industry thinking

More than six out of 10 mid-market businesses (62%) now believe that sustainability is just as important or more important than financial success according to figures from Grant Thornton's International Business Report (IBR). Environmental, social and governance credentials are seen as a competitive advantage for much of the mid-market – reflecting the expectations of their client bases. Among those businesses that are placing a greater emphasis on sustainability, the most common reason is to improve efficiencies and reduce costs (42%) which underscores the real commercial business benefits that they see in this area.

Mid-market businesses are agile, adaptable, and many like to keep ahead of the curve, so sustainability makes sense to them. However, when it comes to reporting on certain aspects of sustainability such as carbon reduction, diversity and inclusion, their business models and adherence to regulatory requirements, many are finding it a challenge to understand what to prioritise.

Regulatory update

APRA: IFRS 17 and LAGIC update & PHI Capital Standards



Conduct & Culture

New Prudential Standard on Remuneration

APRA is implementing a new cross-sector standard, CPS 511 – Remuneration. The new standard, which responds to recommendations of the Financial Services Royal Commission as well as previous APRA reviews, was released in August 2021.

A lighter touch regime will apply to non-Significant Financial Institution's ("non-SFI's"), being entities with assets up to a $20 billion threshold. They will not be subject to minimum deferral, clawback, remuneration framework review, Remuneration Committee, and other SFI requirements.

This will operate alongside the new Financial Reporting Regime.

Financial Accountability Regime

The FAR includes:

- four new functions (dispute resolution, remediation, breach reporting, end-to-end product responsibility) requiring an accountable person (AP).
- impose a new obligation on APs to ensure the entity complies with financial services laws.
- require a minimum 40% of an AP's variable remuneration to be deferred for 4 years, but only where the deferred amount is over $50K.
- exempt 'core' entities (total assets under $10 billion) from requirements to provide accountability statements and maps.
- give regulators extensive new powers to gather information, investigate, issue directions, veto appointments, disqualify APs etc.
- impose heavy penalties for contraventions.

APRA also plans to review Prudential Standard CPS 520 Fit and Proper (CPS 520) to update requirements for fit and proper policies in light of the FAR, and provide consistency in expectations.

Timeline

- **November 2020** – February 2021: CPS 511 second consultation
- **30 April – 23 July:** CPG 511 consultation
- **27 August:** CPS 511 released
- **18 October 2021:** CPG 511 released
- **2022:** consultation on disclosure & reporting requirements to be undertaken
- **1 January 2023:** SFI must be compliant by this date
- **1 January 2024:** non-SFI must be compliant by this date

Timeline

- **22 January – 14 February 2020:** initial FAR Proposals consultation
- **16 July – 13 August 2021:** consultation on ED FAR Bill
- **28 October 2021:** Bill introduced into Parliament
- **1 July 2022:** Banking sector must comply with this regime
- **1 July 2023:** Proposed commencement date for PHI and other regulated insurers

Conduct & Culture

Governance and Risk Management

APRA plans to review its standards for governance and risk management – two foundational elements of the regulatory framework, in 2023.

The review will consider how to improve these standards in a range of key areas, including board and senior management roles and expectations, board obligations for risk culture, the relative emphasis on financial and non-financial risks, and requirements for compliance and audit.

APRA's review of Prudential Standard CPS 510 Governance (CPS 510) and Prudential Standard CPS 220 Risk Management (CPS 220), and the equivalent superannuation standards, will commence in 2023.

Conduct Risk

- Risk culture assessments run by APRA in 2020/1 for larger institutions (across all sectors)
- Expected to trickle down to smaller institutions
- ASIC issued RG271 Internal Dispute Resolution effective 5 October 2021
  - ➢ **ASIC is developing an IDR reporting framework. This follows 2018 legislation permitting ASIC to require IDR reporting by licensees and to publicly release aggregated and firm-specific IDR data**
- ASIC issued RG274 on Design & Distribution Obligations effective 5 October 2021
  - ➢ **new Part 7.8A of Corporations Act**

Timeline

New requirements are not expected to come into effect until 2025.

Business Resilience

Operational resilience

- APRA regards the management of operational risks and business continuity as “core components of financial system resilience”. Among other things, its work will be focused on capturing learnings coming out of entities’ & APRA’s COVID-19 pandemic experience.

- Revision to Outsourcing (CPS 231) and Business Continuity Management (CPS 232) standards expected.

- A new Prudential Standard CPS 230 Operational Risk Management (CPS 230) is expected to update and replace existing requirements in Prudential Standard CPS 231 Outsourcing (CPS 231) and Prudential Standard CPS 232 Business Continuity Management (CPS 232), and the equivalent superannuation standards.

Timeline

- Consultation starts in 2022 with the standards expected to become effective in 2024.

Crisis preparation

Draft Prudential Standard CPS 190 Financial Contingency Planning introduces requirements for all APRA-regulated entities to develop contingency plans to respond to financial stress by either recovering their financial resilience\, or exiting APRA-regulated activities in an orderly manner.

Draft Prudential Standard CPS 900 Resolution Planning requires large or complex entities, or those that provide critical functions to the economy, to be prepared for resolution to minimise the impact on the community and the financial system.

Timeline

- **2 December 2021:** consultation released
- **29 April 2022:** written submissions requested
- **2H 2022:** Finalisation of CPS 120 and CPS 900
- **1 January 2024:** CPS 190 and CPS 900 in force

Technology

As noted in the Information Paper on APRA's Supervision Priorities released earlier this year, with escalating cyber risks, and in line with the Australian Government's Cyber Security Strategy, cyber resilience is a key cross-industry supervision priority. Regulated entities will need to continuously improve their cyber resilience practices to be able to withstand new and more sophisticated cyber-attacks.

CPS234 Information Security – Time to prepare for your Tripartite reviews

APRA has issued notices to regulated financial institutions (ADI's), and many of those reviews are underway. You may have already received your letter and timing from APRA, and if you haven't yet it's time to prepare.

What are these Tripartite reviews and why the focus?

The reviews are part of APRA's four year strategy to increase the rigor of compliance of CPS 234: Information Security and improving cyber resilience across the financial system. They require the Board of regulated entities to engage third party independent Auditors to undertake a thorough CPS 234 compliance audit with the results reported not only to the Board, but also directly to APRA.

When will these be expected?

APRA released its policy and supervision priorities for 2022 earlier this year in which it outlined its development of data collections covering operational and cyber resilience, to inform thematic reviews across a selection of insurers over the course of 2022. The expectation being this is the precursor to the full tripartite reviews.

Our team has had exposure to a number of completed tripartite reviews and tripartite readiness reviews as part of the pilot series for ADI's, and more recently ADI CPS 234 compliance audits due to be completed in September and October of 2022.

We can also provide assistance in developing and enhancing your approach to CPS 234 compliance in order to be better prepared against cyber threats and to better meet the changing regulatory requirements.

Early feedback from APRA's tripartite reviews suggest that all Financial Services organisations should consider what an ongoing assurance roadmap for CPS 234 compliance will look like going forward for FY23 and beyond.

Below are some key areas that financial institutions should be considering:

- Has your organisation identified and documented your information security controls (rather than testing against the APRA standard)?
- Have you implemented an annual plan for testing controls?
- Does your internal audit form clear conclusions on design and operating effectiveness (OE) of controls?
- Does your internal audit plan demonstrate that comprehensive assurance over information security risk is achieved over time and testing is triggered by risks or changes to the IT environment?
- Do you have clarity over the information assets and the controls that are required to protect them?
- Do you have visibility over compliance around third-parties and key suppliers?
- Does your Board reporting process demonstrate how it expects to be engaged with in respect to information security, including the escalation of risks, issues and vulnerabilities?
- Have you considered the expertise and qualifications of personnel conducting information security control testing and performing internal audits under this standard?

Climate risk self-assessment survey

Background

APRA will shortly commence a voluntary survey of medium-to-large APRA-regulated entities, asking them to self-assess how their current practices align to APRA's guidance on managing the financial risks of climate change.

The survey is intended to improve both APRA's and industry's understanding of the approaches being taken by APRA-regulated entities to identify, assess and manage climate related financial risks. In particular, the survey will gather insights on how APRA-regulated entities are currently managing these risks, using APRA's Prudential Practice Guide CPG 229 Climate Change Financial Risks, published on 26 November 2021, as a benchmark.

In addition to providing insights into the management of financial risks arising from climate change, the survey will help incorporate climate-related risks into APRA's supervisory assessments.

Matters to consider

This is a cross industry focus for APRA and while many smaller organisations may not be party to the initial survey, it is important to consider the interaction of climate risk and business activities, and the potential compounding impact on other risks and the internal risk management assessments.

Of particular importance are the following financial risks of climate change:

1) Physical climate risk*: for example changes to the frequency and magnitude of extreme weather events (acute risk), can cause direct damage to assets or property, changes to income and costs, and changes to the cost and availability of insurance.
2) Transition climate risks* include risks related to changes in domestic and international policy and regulatory settings, technological innovation, social adaptation and market changes, which can result in changes to costs, income and profits, investment preferences and asset viability.
3) Liability risks* which have implications for businesses and directors' duties. Liability risks stem from the potential for litigation where institutions and boards do not adequately consider or respond to the impacts of climate change.

Read more

Insurance risk management

Focus Area

In 2023, APRA is planning to review and refresh guidance for life and general insurers on product design, underwriting and risk management in Prudential Practice Guide GPG 240 Insurance Risk (GPG 240) and Prudential Practice Guide LPG 240 Life Insurance Risk and Reinsurance Risk (LPG 240). The intention of this review is to ensure a consistent standard in insurance risk management is maintained across these industries, following supervisory observations and measures in recent years.

APRA plans to consult on potential changes to the prudential framework for insurance risk management in 2023. APRA will also consider whether similar expectations should apply to PHI.

Matters to consider

Whilst this is focused on the Life and General insurers, we expected given APRA's desire to align PHI with the LAGIC framework that this will eventually be a focus area for the PHIs.

ASIC & APRA focus areas

Recognition and measurement

Values of assets

Including intangibles, property, inventories, receivables/loans, investments, other financial assets, contract assets and deferred tax assets

Liabilities

Including provisions for onerous contracts, financial guarantees and restructuring

Disclosures

Sources of estimation uncertainty

Key assumptions and sensitivity analysis

Operating and financial review (OFR)

Underlying drivers of results, business strategies, risks and future prospects.

Going concern assessments and solvency

Subsequent events

Deferred Claims Liability

As noted in the Information Paper on APRA's Supervision Priorities, the prudent management of the unwinding of the Deferred Claims Liability will continue to be a focus area of APRA's. In June 2020, APRA issued private health insurers with guidance on how to treat the liability arising for claims deferred due to COVID-19 (known as the DCL). In March, APRA announced its move towards a principles-based approach which places greater reliance on insurers to manage their specific risks and calculate their Deferred Claims Liability. This announcement resulted in the removal of the prescriptive option for the valuation of the Regulatory Balance Sheet; the removal of minimum constraints to the valuation of the DCL for the Capital Adequacy Requirement; and revised the guidance for the Capital Adequacy Requirement. Notwithstanding these changes, APRA is still continuing to monitor closely the ongoing management of the DCL and expects entities will remain prudent in managing the DCL, earnings and capital impacts.